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TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

FINANCIAL STATEMENTS

Years Ended December 31, 2005 and 2004

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

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SECTION I
FINANCIAL SECTION
FINANCIAL STATEMENTS

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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Terrace Gardens, Inc.
(A California Nonprofit Public Benefit Corporation)
Milpitas, California

We have audited the accompanying statements of financial position of Terrace Gardens, Inc. (a California nonprofit public benefit corporation) as of December 31, 2005, and the related statements of activities, functional expenses, and cash flows for the year then ended. These financial statements are the responsibility of the Organization's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Organization as of December 31, 2004 were audited by other auditors whose report dated March 18, 2005 expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Terrace Gardens, Inc. as of December 31, 2005, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Berger/Lewis Accountancy Corporation

BERGER/LEWIS ACCOUNTANCY CORPORATION
San Jose, California
March 15, 2006

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

STATEMENTS OF FINANCIAL POSITION

December 31, 2005 and 2004

	ASSETS	
	2005	2004
CURRENT ASSETS:		
Cash	\$ 27,844	\$ 15,065
Tenant Accounts Receivable	2,723	3,759
Accounts Receivable - Other	1,437	-
Prepaid Expenses	30,807	45,904
Total Current Assets	62,811	64,728
PROPERTY AND EQUIPMENT, At Cost:		
Land	1,565,277	1,565,277
Buildings and Improvements	11,794,701	11,601,281
Furnishings and Equipment	277,859	277,859
	13,637,837	13,444,417
Accumulated Depreciation	(4,184,199)	(3,935,780)
Total Property and Equipment, Net	9,453,638	9,508,637
TENANT SECURITY DEPOSITS:		
Tenant Security Deposits	74,542	76,021
RESTRICTED CASH AND FUNDED RESERVE:		
Replacement Reserve	876,293	953,611
Restricted Cash for Carillon Maintenance Fund	784	844
Total Restricted Cash and Funded Reserves	877,077	954,455
TOTAL ASSETS	\$ 10,468,068	\$ 10,603,841
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts Payable	\$ 61,650	\$ 56,157
Other Accrued Liabilities	26,698	26,838
Rents Received in Advance	55	203
Total Current Liabilities	88,403	83,198
TENANT SECURITY DEPOSITS		
Tenant Security Deposit Liability	74,731	76,312
Total Liabilities	163,134	159,510
NET ASSETS:		
Unrestricted Net Assets	10,304,150	10,443,487
Temporarily Restricted Net Assets	784	844
Total Net Assets	10,304,934	10,444,331
TOTAL LIABILITIES AND NET ASSETS	\$ 10,468,068	\$ 10,603,841

The Accompanying Notes are an Integral Part of these Financial Statements.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

STATEMENTS OF ACTIVITIES

Years Ended December 31, 2005 and 2004

	2005	2004
REVENUE:		
Rental Program:		
Gross Residential Rent Potential	\$ 920,012	\$ 855,671
Vacancy and Collection Loss	<u>(9,788)</u>	<u>(9,900)</u>
Net Residential Rental Income	910,224	845,771
Laundry and Vending Income	1,535	1,644
Other Tenant Charges	4,442	1,086
Tenant Guest Income	<u>7,630</u>	<u>7,260</u>
Rental Program Revenue	923,831	855,761
Food Services	368,339	365,444
Interest Income	<u>18,738</u>	<u>4,547</u>
Total Revenue	1,310,908	1,226,752
Net Assets Released from Restrictions	<u>60</u>	<u>-</u>
Total Revenue and Net Assets Released from Restrictions	<u>1,310,968</u>	<u>1,226,752</u>
PROGRAM EXPENSES:		
Rental Program:		
Administrative	87,279	98,455
Personnel and Benefits	330,706	320,535
Repairs and Maintenance	137,764	150,156
Taxes and Insurance	102,265	101,265
Utilities	<u>148,584</u>	<u>133,893</u>
Rental Program Expenses	806,608	804,214
Tenant Services Program:		
Food Service Contract	375,729	369,861
Recreation	<u>6,049</u>	<u>7,707</u>
Tenant Services Program Expenses	381,778	377,568
Total Operating Expenses	1,188,386	1,181,782
Other Expenses:		
Depreciation	<u>248,419</u>	<u>253,320</u>
Total Program Expenses	<u>1,436,805</u>	<u>1,435,102</u>
Supporting Services Expense:		
Management and General Expenses	<u>13,500</u>	<u>8,116</u>
Total Expenses	<u>1,450,305</u>	<u>1,443,218</u>
Change in Unrestricted Net Assets	(139,337)	(216,466)
Temporarily Restricted Net Assets Released from Restriction	<u>(60)</u>	<u>-</u>
CHANGE IN NET ASSETS	(139,397)	(216,466)
NET ASSETS, Beginning of Year	<u>10,444,331</u>	<u>10,660,797</u>
NET ASSETS, End of Year	<u>\$ 10,304,934</u>	<u>\$ 10,444,331</u>

The Accompanying Notes are an Integral Part of these Financial Statements.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

STATEMENTS OF CASH FLOWS

Years Ended December 31, 2005 and 2004

	<u>2005</u>	<u>2004</u>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in Net Assets	\$ (139,397)	\$ (216,466)
Adjustments to Reconcile Change in Net Assets to Net Cash Provided by Operating Activities:		
Depreciation	248,419	253,320
(Increase) Decrease in Assets:		
Tenant Accounts Receivable	1,036	(71)
Accounts Receivable - Affiliate	(1,437)	-
Prepaid Expenses	15,097	3,207
Increase (Decrease) in Liabilities:		
Accounts Payable	5,493	3,724
Other Accrued Liabilities	(140)	(6,455)
Rents Received in Advance	(143)	(81)
Tenant Security Deposits - Net	<u>(102)</u>	<u>1,715</u>
Net Cash Provided by Operating Activities	<u>128,821</u>	<u>38,903</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Funding of Replacement Reserves	(118,727)	(93,264)
Withdrawal from Replacement Reserves	196,045	53,594
Acquisition of Property and Equipment	(193,420)	-
Withdrawals from Restricted Cash	<u>60</u>	<u>1,601</u>
Net Cash Used by Investing Activities	<u>(116,042)</u>	<u>(38,069)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	12,779	834
CASH AND CASH EQUIVALENTS, Beginning of Year	<u>15,065</u>	<u>14,231</u>
CASH AND CASH EQUIVALENTS, End of Year	<u>\$ 27,844</u>	<u>\$ 15,065</u>

The Accompanying Notes are an Integral Part of these Financial Statements.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - GENERAL INFORMATION:

Organization - Terrace Gardens, Inc. (the "Organization") is a nonprofit public benefit corporation, incorporated in the State of California on September 12, 1986. The Organization was formed to provide low income persons in the City of Milpitas (the "City") with housing facilities and services. The Organization is governed by a nine member board of directors, one of whom must be the City Manager of the City, or his appointee; one of whom must be a member of the City Council; five of whom must be residents of the City; and the remaining two members may be selected without regard to residence.

The Board of Directors' governing authority is limited by a Regulatory Agreement, dated November 17, 1987, between the Organization and the City. Significant provisions of this agreement are described in Note 2. The Organization and the City are currently considering a major revision to the Regulatory Agreement.

Operations - The Organization's purpose is to develop and manage the operations of a residential complex which consists of 148 rental units, 3 guest rooms, and 2 staff units. The complex is located in the City and dedicated to the needs of elderly persons. The City contributed the land for the complex and the value is reported in the financial statements at its estimated fair market value at the date contributed as determined by the County Assessor.

NOTE 2 - REGULATORY AGREEMENT

Pursuant to an Agreement dated November 17, 1987 with the City, the Organization is:

Prohibited From:

- Using the land contributed by the City for any purpose other than constructing and operating the Terrace Gardens residential project.
- Encumbering the land or project by any security interest, selling, assigning, conveying or otherwise transferring its interest in the project or project site.
- Discriminating in any manner against any person on account of race, marital status, sex, religious creed, ancestry, national origin or physical handicaps in connection with constructing or operating the project.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

NOTES TO FINANCIAL STATEMENTS

NOTE 2 - REGULATORY AGREEMENT (Continued):

Required To:

- Maintain adequate insurance coverage, indemnify and hold harmless the City and its officials and employees against any actual or alleged liabilities resulting from any acts or omissions of the Organization or its employees.
- Submit operating budgets on or before the first day of each fiscal year to the City for approval.
- Establish a reserve account for replacement and other project contingencies which must be funded at the rate of \$4,000 per month. (See Note 5 for details on reserves)
- Limit occupancy in the project to persons 62 or more of age (in the case of joint occupancy at least one occupant must meet the age requirement) or 55 or more of age and handicapped.
- Rent dwelling units by giving preference first to elderly residents and to elderly parents of residents of the City, and finally to residents of Santa Clara County.
- Limit rent in an amount not to exceed 30% of occupant's income, unless otherwise agreed by both the City and the Organization, but in no event can the rent exceed the fair market rental value of the occupant's apartment (with the 2005 minimum to maximum monthly rent of \$368 to \$786).
- Establish and maintain a surplus cash account, disbursements from which can only be made with the City's prior written approval and which must be disbursed to the City 30 days after receiving the City's written request for all or a portion of the surplus funds.
- Provide the City with annual financial statements audited by an Independent Certified Public Accountant.

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

Basis of Accounting - The Organization recognizes revenue on the accrual basis of accounting. Revenue from program fees are recognized as revenue in the period in which the service is provided. The value of the rent-free employee units is shown as rental income and as an expense of operations.

Basis of Presentation - Financial statement presentation follows the recommendation of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-for-Profit Organizations*. Under SFAS No. 117, the Organization is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. There were no permanently restricted assets as of December 31, 2005 and 2004

Unrestricted net assets include those assets over which the Board of Directors has discretionary control in carrying out the operations of the Organization. Under this category, the Organization maintains an operating fund, property and equipment fund plus any net assets designated by the Board for specific purposes.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Temporarily restricted net assets include those assets which are subject to donor restriction and for which the applicable restriction was not met as of the year end of the current reporting period.

Permanently restricted net assets include those assets which are subject to a non-expiring donor restriction, such as endowments.

Use of Estimates - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the period. Accordingly, actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents include highly liquid investments and investments with a maturity of three months or less, and exclude donor restricted receipts and amounts designated for long-term purposes.

The Organization maintains its cash in bank deposit accounts which, at times, may exceed Federally insured limits. The Organization has not experienced any losses in such accounts. Management believes it is not exposed to any significant risk on cash accounts.

Accounts Receivable - The Organization uses the specific write-off method to provide for doubtful accounts since past experience and management's estimation indicates an adequate allowance for such accounts is immaterial.

Property and Equipment - Property and equipment are recorded at cost or estimated fair value for donated items. The cost of repairs and maintenance which do not improve or extend the lives of the respective assets are expensed currently. Depreciation is computed on the straight-line method based on the estimated useful lives of the assets, which range from 5 to 50 years. Depreciation is charged to the activity benefiting from the use of the property or equipment. Depreciation expense for the years ended December 31, 2005 and 2004 was \$248,419 and \$253,320, respectively.

Tenant Security Deposits - Tenant security deposits are not available for operating purposes. The Organization is required to maintain funds equal to the related liability and holds the funds in separate, interest bearing accounts in the name of the Organization.

Functional Expenses - Directly identifiable expenses are charged to program and supporting services. Management and general expenses include those expenses that are not directly identifiable with any other specific function but provide for the overall support and direction of the Organization.

Property Taxes - The Organization has filed and received an exemption from certain property taxes in accordance with Section 214 of the California Code.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

NOTES TO FINANCIAL STATEMENTS

NOTE 3 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued):

Income Taxes - Terrace Gardens, Inc. is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code and Section 23701(d) of the California Revenue Taxation Code. Accordingly, no provision for income taxes has been made in the accompanying statements. In addition, the Organization qualifies for the charitable contribution deduction under Section 170(b)(1)(A) of the Internal Revenue Code and has been classified as an organization that is not a private foundation under Section 509(a)(1) of the Internal Revenue Code.

Advertising - The Organization's policy is to expense advertising costs as the costs are incurred. Advertising expenses for the years ended December 31, 2005 and 2004 was \$49 and \$5,617, respectively.

NOTE 4 - COMPARATIVE FINANCIAL INFORMATION:

Certain reclassifications have been made to the statement of position, statement of activities and statement of cash flows for the year ended December 31, 2004 for comparative purposes.

NOTE 5 - RESTRICTED CASH AND FUNDED RESERVE:

Replacement Reserve - In accordance with the Regulatory Agreement, a replacement reserve account has been established and is to be funded monthly. The annual funding required is \$48,000. Funding was increased from the requirement amount based on a 3 year Replacement Reserve Study, conducted in 2003, for the Organization. Interest earned on the replacement reserve is considered to have the same restrictions as the replacement reserve. As of December 31, 2005, the replacement reserve is as follows:

	<u>2005</u>
Balance at January 1,	\$ 953,670
Monthly Deposits	99,996
Interest Received	18,731
Withdrawals	<u>(196,104)</u>
Balance at December 31,	<u>\$ 876,293</u>

Restricted Cash - The restricted cash consists of funds from the Carillon Memorial Maintenance Fund, held for the repair or improvement of the Carillon. These funds are restricted in use and may not be used for operations.

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

NOTES TO FINANCIAL STATEMENTS

NOTE 6 - SURPLUS CASH (DEFICIENCY):

Under Section 23 of the Regulatory Agreement dated November 17, 1987 with the City of Milpitas, the Organization is required to remit surplus cash to the City upon receipt of 30 days written notice. Surplus cash is defined by that agreement as cash remaining after payment of all liabilities less amounts required for reserves. Surplus cash at December 31, 2005, is computed as follows:

COMPUTATION OF SURPLUS CASH	
Account Description	Value
Cash	\$ 27,844
Total Cash	<u>27,844</u>
Accounts Payable (Due within 30 days)	(61,650)
Rents Received in Advance	<u>(55)</u>
Total Current Obligations	<u>(61,705)</u>
Surplus Cash (Deficiency)	\$ <u>(33,861)</u>
Deposit Due Surplus Cash Account	\$ <u>-</u>

SECTION II
SUPPLEMENTARY INFORMATION

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

OPERATING PROGRAM EXPENSES

Years Ended December 31, 2005 and 2004

	2005		2004	
	Amount	Percent of Total Revenue	Amount	Percent of Total Revenue
ADMINISTRATIVE:				
Advertising	\$ 49	- %	\$ 5,617	0.5 %
Bookkeeping	13,500	1.0	13,500	1.1
Management Fees	46,212	3.5	46,212	3.8
Mileage and Travel	242	-	208	-
Miscellaneous	469	-	6,420	0.5
Office Administration	17,959	1.4	16,720	1.4
Security	1,223	0.1	771	0.1
Telephone	7,525	0.6	9,007	0.7
Total Administrative Expense	87,279	6.7	98,455	8.0
PERSONNEL AND BENEFITS:				
Administrative Salaries	126,184	9.6	121,548	9.9
Health Insurance	26,240	2.0	26,841	2.2
Janitor Salary	37,960	2.9	33,863	2.8
Maintenance Salaries	75,111	5.7	72,212	5.9
Manager's Rent Free Unit	7,964	0.6	-	-
Payroll Taxes	20,645	1.6	21,182	1.7
Workers' Compensation Insurance	36,602	2.8	44,889	3.7
Total Personnel and Benefits Expense	330,706	25.2	320,535	26.1
REPAIRS AND MAINTENANCE:				
Decorating and Painting	425	-	3,571	0.3
Elevator Maintenance	11,886	0.9	9,829	0.8
Exterminating	681	0.1	970	0.1
Fire Alarm Expense	3,899	0.3	10,938	0.9
Grounds Contract	17,830	1.4	20,407	1.7
Ground Supplies	1,358	0.1	2,753	0.2
Heating/Cooling Repairs	18,109	1.4	16,408	1.3
Janitor	4,643	0.4	7,108	0.6
Miscellaneous	6,178	0.5	421	-
Miscellaneous Equipment Repair	212	-	524	-
Plumbing Maintenance	4,926	0.4	1,618	0.1
Repairs and Maintenance Contracts	486	-	324	-
Repairs Contract	29,007	2.2	30,364	2.5
Replacements	16,990	1.3	26,394	2.2
Rubbish Removal	19,168	1.5	18,527	1.5
Window and Glass Repairs	1,966	0.1	-	-
Total Repairs and Maintenance Expense	137,764	10.5	150,156	12.2

TERRACE GARDENS, INC.
(A California Nonprofit Public Benefit Corporation)

OPERATING PROGRAM EXPENSES
(Continued)

Years Ended December 31, 2005 and 2004

	<u>2005</u>		<u>2004</u>	
	<u>Amount</u>	<u>Percent of Total Revenue</u>	<u>Amount</u>	<u>Percent of Total Revenue</u>
TAXES AND INSURANCE:				
Fidelity Bond Insurance	263	-	260	-
Property Insurance	92,912	7.1	94,275	7.7
Property Taxes	6,796	0.5	6,675	0.5
Other Taxes	2,289	0.2	55	-
Total Taxes and Insurance Expense	<u>102,265</u>	<u>7.8</u>	<u>101,265</u>	<u>8.3</u>
UTILITIES:				
Electricity	72,451	5.5	65,613	5.3
Gas	27,384	2.1	20,375	1.7
Sewer	13,204	1.0	9,028	0.7
Water	35,555	2.7	38,787	3.2
Total Utilities Expense	<u>148,594</u>	<u>11.3</u>	<u>133,803</u>	<u>10.9</u>
FOOD SERVICE CONTRACT:				
Food Service Costs	<u>375,729</u>	<u>28.7</u>	<u>369,861</u>	<u>30.1</u>
Total Food Service Contract Expense	<u>375,729</u>	<u>28.7</u>	<u>369,861</u>	<u>30.1</u>
RECREATION:				
Recreation Supplies	<u>6,049</u>	<u>0.5</u>	<u>7,707</u>	<u>0.6</u>
Total Recreation Expense	<u>6,049</u>	<u>0.5</u>	<u>7,707</u>	<u>0.6</u>
Total Operating Expenses	<u>\$ 1,188,386</u>	<u>90.7 %</u>	<u>\$ 1,181,782</u>	<u>96.2 %</u>